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held at the Palais des Nations, Geneva,
from 3 to 7 April 1995

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Report of the Ad Hoc Working Group on the Role of Enterprises in Development on its first session

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UNITED NATIONS

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INTRODUCTION

1. The first session of the Ad Hoc Working Group on the Role of Enterprises in Development was held from 3 to 7 April 1995 at the Palais des Nations, Geneva. In the course of the session, the Ad Hoc Working Group held four plenary meetings and seven informal meetings.

A. Opening statement

2. The **Officer-in-charge of UNCTAD**, in welcoming the participants to the session, referred to the valuable country studies which Governments had prepared as inputs to the deliberations. The issues under consideration - trade, investment and technology as well as social aspects - were those at the very heart of the development process. In the light of major changes in the world economy, the successful conclusion of the Uruguay Round and the establishment of the new World Trade Organization, it was opportune to discuss economic liberalization and global and regional interlinkages of production, marketing and distribution because in all these developments the key actors were enterprises, primarily those in the private sector. Small and medium-sized enterprises (SMEs) accounted for over 90 per cent of firms in most countries. They were crucial to economic and social development and net job-creators even in periods of recession. As creators of wealth, they were one of the main instruments for the eradication of poverty.

3. In the face of intensifying competition, globalization and technology-led specialization, many large firms were out-sourcing tasks and components to smaller firms. SMEs, being adaptable and flexible because of their size, were thus in a position to help spearhead innovation at the forefront of competitiveness. Moreover, the interlinkages which they formed at the domestic level helped to promote economies of flexible specialization; at the global level, in teaming up with foreign firms to supply export markets, they created linkages for export development. In order to foster such development, Governments had created, inter alia, export processing zones, special economic zones and growth triangles. A supportive legal and regulatory environment for enterprise and export development was necessary as well as measures to help SMEs overcome constraints to their internationalization efforts. Examination of country experiences could help define the essential elements of such an enabling environment. As for the design and implementation of support programmes for SMEs which did not stifle private sector initiatives, the policies and strategies most supportive of different types of SMEs, the institutions and the respective roles of the public and private sector - these were questions that the session might wish to explore, along with the factors which determine the success of industrial districts, such as, for example, hard work, entrepreneurial ability, trust, community spirit and institutional support. Moreover, because of the incidence of micro-enterprises in the economies of developing countries, it might be useful to look at policies and measures most likely to help such enterprises integrate themselves into the formal economy. He expressed confidence that exchanges and insights shared during the session would lead to the identification of "best practices" and other vital elements of policy at the national and international levels by which to enhance the role of enterprises in promoting development.

Chapter I

ROLE OF THE STATE IN CREATING AN ENABLING ENVIRONMENT FOR THE PROMOTION OF ENTREPRENEURSHIP AND THE VIABLE DEVELOPMENT OF ENTERPRISES, ESPECIALLY SMEs, WITH REFERENCE TO THE FOLLOWING TOPICS:

(a) Regulatory framework and incentives structure

(b) Human resources development

(c) Institution building and institutional support

(d) The informal sector and its integration into the formal economy

(Agenda item 3)

and

EXPORT DEVELOPMENT AND THE ROLE OF SMEs, GIVING DUE CONSIDERATION TO POSSIBLE ADVANTAGES ARISING FROM THE GLOBALIZATION PROCESS

(Agenda item 4)

4. For its consideration of these items, the Ad Hoc Working Group had before it the following documentation:

"Creating an enabling environment for the development of enterprises, particularly small- and medium-sized enterprises", Report by the UNCTAD secretariat (TD/B/WG.7/2);

"The role of small- and medium-sized enterprises in export development", Report by the UNCTAD secretariat (TD/B/WG.7/3).

5. The **Chief, Privatization and Enterprise Development Unit**, referred to the important questions raised in the introductory statement by the Officer-in-charge of UNCTAD and noted that the above reports, based as they were on an analysis of country experiences and of the literature, had attempted to respond to some of these questions. This would no doubt be enriched by the discussions during the session and the lessons learned and insights gained from practical experience. TD/B/WG.7/2 had addressed issues related to the role of the state in creating an enabling environment for the promotion of entrepreneurship and enterprises, by exploring the regulatory framework and incentives, human resources development, institution-building and institutional support as well as the integration of the informal sector into the formal economy. TD/B/WG.7/3 dealt with policies for stimulating export development, the vital role of SMEs, how the impact of globalization interacted with this process and the internationalization of SMEs. It also covered policy initiatives and measures supporting the export development of SMEs with reference to particular schemes and the role of public institutions and private sector networks. Examples of supporting activities of international organizations and donors were also discussed along with the question of niche market development. In closing, he emphasized the importance of inter-firm cooperation, for example, in the context of joint

ventures, subcontracting, franchising, creation of alliances, establishment of marketing networks, for achieving flexible specialization, industrial and technological upgrading as well as export development and competitiveness, so essential for countries and their enterprises in order to benefit from a globalizing and liberalizing world economy.

6. The representative of **Japan** underlined the importance of enterprises in general for the creation of employment opportunities, productivity gains, technological advances, alleviation of balance-of-payments constraints and economic diversification. While large enterprises tended to be capital-intensive, SMEs were labour-intensive and therefore one of their great merits was job creation. They often complemented large enterprises by strengthening the latter's output. Through the linkages which they established, they could eventually change the economic structure of a country. The globalization trend offered developing countries opportunities to build up their domestic industries. SMEs could make a crucial contribution to this process, particularly through complementary supply links with transnational enterprises. He cited some of the obstacles hindering SMEs from developing by themselves, among them lack of market information and knowledge of modern management techniques, human resources constraints and difficulties in raising capital. For this reason, Governments needed to create a favourable environment. International cooperation was important in this regard. An APEC Ministerial meeting held in Osaka in 1994 had focused on fostering healthy SMEs as the foundation of economies.

7. He then described his country's policy for promoting SMEs as being flexible and dynamically adjusted to the changing domestic and international environment. The approach was essentially one of non-interference. Industrial policy sought to build up and deepen firm-level capabilities through vertical integration. The result was a multi-layered, pyramidal structure. In Japan, SMEs were facing a choice between internationalization or shifting to knowledge-intensive industries. Management guidance was thus the latest policy initiative. He also referred to the establishment in 1948 of the Small and Medium Enterprises Agency as a support measure. Government financial institutions had provided short and long-term capital loans for SMEs at less than market rates. Various laws and legal measures had been introduced to facilitate their development. Finally, he referred to the technical cooperation assistance which his country was providing by accepting trainees from developing countries for courses on small industry development. Moreover, a loan to the Grameen Bank in Bangladesh was under study.

8. The representative of **France**, speaking on behalf of the **European Union**, expressed gratification that UNCTAD was addressing the important question of the role of enterprises, particularly SMEs, as determinants of growth and development. The two themes of the Ad Hoc Working Group were complementary, bearing on the role of the State and the role of SMEs in export development. It was indicative of the importance of the Group's work that the outcome of the current session would undoubtedly serve as a valuable input for UNCTAD IX, particularly with reference to item 3 of the provisional agenda of the Conference. In closing, he commended the secretariat for the high quality and timeliness of the documentation prepared for the session.

9. The representative of the **Philippines** said that the documentation prepared for the session was probably the most comprehensive on the subject to date and was much appreciated. The Group's work was of great importance in view of the fact that SMEs constituted 90 per cent of all enterprises in the vast majority of countries, particularly the developing ones. Assisting them was critical for accelerating the development process. SMEs had long played a vital role in his country's economy and national policy had been influential for their development. Now that the emphasis was on export-led growth, SMEs were switching to exports, depending on their degree of awareness and capabilities. Their encouragement in this endeavour was a main element in the country's outward-looking, market-oriented policy. To this end, cooperatives and credit support were being established with emphasis on rural development strategies. Legislation such as Republic Act 6810 had constituted a "Magna Carta" for rural business enterprises and entitled them to many benefits.

10. The representative of **Romania** drew attention to the importance of the issues which were before the Group and commended the secretariat for its informative reports. She then listed three points of particular relevance to the current discussions. First, the work should be action-oriented, in the Cartagena spirit, deriving practical recommendations useful for the development of small- and medium-sized enterprises in developing countries and countries in transition. Secondly, it was hoped to learn from others' experience with effective implementation of regional development programmes and ways and means to promote exports through SMEs. While her country had created the legal framework, it still lacked the expertise that would enable it to support SMEs' development. The law provided for diffusion of financial and market information and help with training and advertising. Thirdly, the Group might profitably consider how international cooperation could be strengthened both at intergovernmental and enterprise level in order to promote growth through SMEs.

11. The representative of **Germany** said that his country owed its economic strength primarily to skilled manpower. The crucial factors for its efficiency were the training and industriousness of the labour force, its managerial abilities and the possibilities offered by the social market economy. The market system combined individual initiatives with the principles of social progress. The basic law guaranteed freedom of private enterprises and private property as basic rights to be exercised for the common good. Under the motto "as little government intervention as possible, as much government intervention as necessary," the State had primarily a regulatory function. Market forces dictated goods, services and prices. The prerequisite for the functioning of the market mechanism was competition. The law against Restraints of Competition, first enacted in 1957, controlled cartels through the Federal Cartel Office. The State sought to ensure that competition did not result in conditions unacceptable in social terms. In several sectors market access was subject to legal stipulations. Certain sectors of the economy were not completely subject to the profit imperative, for example those in the former State enterprises in eastern Germany, although the intention was to incorporate them gradually into the market system. The labour market as well was characterized by the free play of market forces. The unions and employers engaged in free collective bargaining had great responsibility for the economy as a whole. Higher investment was seen as the

key to resolving the employment problem which was compounded by the financial burden of rebuilding the economies of the new federal states. The Government was engaged in strengthening the market's own forces through incentives while reducing state influence on the economy. Germany favoured free world trade and rejected all forms of protectionism. Indeed, Germany was heavily dependent on open markets, in fact exports amounted to one-third of GNP. He concluded by stressing that open markets and free world trade were of vital interest to entrepreneurs.

12. The representative of **Egypt** referred to the economic reforms in which his country had been engaged and said that in view of the importance of SMEs, he would like to add to the previous speakers' remarks. The State was no longer directly involved in economic activity. As an economic democracy went hand in hand with a political democracy, any obstacles to progress in the private sector had to be removed. The task of Government since the introduction of economic reforms and implementation of privatization programmes had evolved into restructuring of public companies and their listing on the stock exchange. New legislation had been based on successful experience in other countries such as, for example, Japan. Reforms had enabled SMEs to benefit from free provision of land in rural areas and to enjoy 5 to 10 year exemptions from taxation. To facilitate the establishment and growth of SMEs, a Social Fund for Development (SFD) had been set up. The UNCTAD documentation had been useful and further studies and additional technical advice should be encouraged. He elaborated on his country's experience regarding SME development which was supported through the recently established SFD. Among the main objectives were enhancement of economic efficiency and creation of employment. In this regard, special attention was being paid to the advancement of women and the protection of the environment. The particular task of the SFD was to facilitate the creation of new SMEs and the expansion of existing SMEs. The selection of enterprises was based on the following criteria: potential for employment expansion, existence of viable opportunities, technological capacity, prospects for sustainable development and the quality of management. With respect to lending to SMEs, preferential interest rates of 9 per cent per annum were made available, as compared to the current standard rate of 16 per cent. These loans were being handled with the help of NGOs. Obstacles encountered included: identification of eligible entrepreneurs, bureaucratic "red tape", lack of funds, marketing and distribution problems and monopoly power of transnational corporations.

13. The representative of **South Africa** gave an overview of the process under way in his country to determine the State's role in creating an enabling environment for small business, emphasizing that his Government was committed to economic empowerment and growth. The reality of millions of unemployed or under-employed South Africans necessitated job creation and generation of sustainable and equitable growth. It was understood that the real engine for such growth was the private sector but that the Government must help create the enabling environment. The promotion of the small-enterprise sector was one of the priorities identified to be addressed by the Reconstruction and Development Programme. Successful small-, medium- and micro-enterprises (SMMEs) were deemed crucial for job creation, economic growth and equitable development. In his country there were over 800,000 SMMEs, employing about one quarter of the labour force. He enumerated the factors for a successful SMME promotion strategy: a legal and regulatory environment, access to

markets and finance, affordable business premises, skill acquisition and access to appropriate technology. Those groups requiring special consideration included people in disadvantaged rural areas and women. He then drew attention to some relevant factors for SMME development which had been neglected, such as state procurement and subcontracting, specialized credit-guarantee schemes and sector-specific training programmes. His country was reconsidering a policy framework for SMME development in consultation with small businesses and communities. In this connection, he referred to the recent White Paper on the National Strategy for the Development and Promotion of Small Business in South Africa. He also informed the Group about the recent national Conference on Small Business Development and mentioned the imminent creation of a Chief Directorate for Small Business Development within the Ministry of Trade and Industry. Finally, he identified the objectives in support of SMMEs' development in South Africa where the Government would assume overall coordination in their promotion. The primary aim was to "create an enabling environment for small enterprises".

14. The representative of **Ethiopia** took the floor to update the country submission (TD/B/WG.7/Misc.10). Studies aimed at improving the urban land policy were under way, and the land issue had meanwhile been resolved. The urban land lease policy had provided SMEs with the land needed so that there was no discrimination between large and small enterprises. The privatization agency had identified enterprises to be privatized by the end of June 1995, consisting of four sectors: hotels; retail trade; agriculture; and industry. Priority had been given to enterprises with assets of less than 20 million birr (approximately US$ 3.3 million) which covered between 51 and 75 per cent of all enterprises to be privatized. In order to alleviate an unbalanced level of development among regions, the Government had decided to grant differential incentives, thus promoting investment in less advanced regions.

Chapter II

OTHER BUSINESS

15. The representative of **Costa Rica** said that her Government took great interest in the issues under consideration by the Ad Hoc Working Group. She announced that her country had transmitted a document on the role of enterprises in national development, which was being circulated under symbol TD/B/WG.7/Misc.15. This document contained information on legislation in Costa Rica relevant to small- and medium-sized enterprises, including micro-enterprises, as well as on existing fiscal incentives. A formal presentation of the document, which described the main pillars of the Government's policy on small- and medium-sized enterprises, was planned for the second session of the Ad Hoc Working Group.

Chapter III

PROCEEDINGS OF THE 4TH (CLOSING) PLENARY MEETING

A. Action by the Ad Hoc Working Group

16. At the 4th (closing) plenary meeting of its first session, the Ad Hoc Working Group decided to take note of the summary prepared by the secretariat covering the deliberations during the informal meetings, and to annex this summary to the report of the session (annex II).

B. Closing statements

17. The spokesman for the **Latin American Group** (Argentina) took the floor to praise the invited experts and the secretariat for having done so much to make the session useful and rewarding. He likewise commended the Chairman for the cordial atmosphere that had prevailed under his able leadership.

18. The spokesman for the **African Group** (Algeria) noted that the Chairman's competence and experience had greatly contributed to the accomplishment of useful work during the session. The exchange of experiences on the promotion of SMEs had been most productive. Likewise, the analysis of the points under discussion had been particularly valuable. In closing, he thanked the secretariat for the high-quality documentation that had been provided.

19. The spokesman for **Group B** (Switzerland) said that the Chairman's experience and warm sense of humour had put everyone at ease. Moreover, his ability to summarize the salient points had greatly contributed to smooth discussions and an understanding of the issues. Group B was eagerly looking forward to cooperating in the work of the second session.

20. The representative of **Bangladesh**, on behalf of the **Asian Group**, thanked the Chairman and Bureau for all that they had done to make the session a rewarding experience and also praised the secretariat for its vital contributions.

21. The representative of **China** said that the Chairman's rich experience and diplomatic skills had played an important role in making the session a success. The exchanges that had taken place had beneficial implications for the formulation of better policies towards SMEs and the further growth of SMEs in all countries, particularly in developing countries. In closing, he thanked the Chairman, Bureau, panellists and secretariat for their outstanding efforts.

22. The representative of **France**, speaking on behalf of the **European Union**, noted the keen interest shown by all participants in the work of the Group as well as the Group's evident ability to treat important questions in depth. The European Union attached great importance to the work and was eagerly anticipating the second session.

Chapter IV

ORGANIZATIONAL MATTERS

A. Opening of the session

23. The first session of the Ad Hoc Working Group was opened on 3 April 1995 by the Officer-in-charge of UNCTAD.

B. Election of officers

24. The **Officer-in-charge of UNCTAD** recalled that in accordance with rules 18 and 19 of the rules of procedure of the Main Committees of the Board and following consultations with regional coordinators, the Chairman of the Group was to be elected from among the representatives of the countries members of Group C. Following a decision of the Board, it had also been agreed that, as far as the Ad Hoc Working Groups were concerned, the Chairman and members of the Bureau once elected would remain in office for the life of the Ad Hoc Working Group.

25. At its 1st plenary meeting, on 3 April 1995, the Ad Hoc Working Group elected its officers as follows:

Chairman:	Mr. Anthony Hill (Jamaica)
Vice-Chairmen:	Mr. J. Yambao (Philippines) Mr. R. Weber (Switzerland) Mr. V. Skliarov (Russian Federation) Mr. M. Mohammed Salem (Egypt) Ms. V. Fonseca (Venezuela)
Rapporteur:	Mrs. H. Booth di Giovanni (United Kingdom of Great Britain and Northern Ireland)

C. Adoption of the agenda and organization of work

26. At its 1st plenary meeting on 3 April 1995, the Ad Hoc Working Group adopted its provisional agenda (TD/B/WG.7/1) as follows:

1. Election of officers

2. Adoption of the agenda and organization of work

3. Role of the State in creating an enabling environment for the promotion of entrepreneurship and the viable development of enterprises, especially SMEs, with reference to the following topics:

   (a) Regulatory framework and incentives structures;

   (b) Human resources development;

(c) Institution building and institutional support;

(d) The informal sector and its integration into the formal economy;

4. Export development and the role of SMEs, giving due consideration to possible advantages arising from the globalization process

5. Provisional agenda for the second session of the Ad Hoc Working Group

6. Other business

7. Adoption of the report of the Ad Hoc Working Group to the Trade and Development Board.

D. Provisional agenda for the second session of the Working Group

(Agenda item 5)

27. At the 4th (closing) plenary meeting of its first session, the Ad Hoc Working Group approved the provisional agenda for its second session. (For the text of the provisional agenda, see annex I.)

E. Adoption of the report of the Ad Hoc Working Group to the Trade and Development Board

(Agenda item 7)

28. At its 4th (closing) plenary meeting, on 7 April 1995, the Ad Hoc Working Group adopted its draft report (TD/B/WG.7/L.1 and Add.1) and authorized the Rapporteur to complete the report to reflect the proceedings of the closing plenary.

Annex I

PROVISIONAL AGENDA FOR THE SECOND SESSION OF THE AD HOC WORKING GROUP

1. Election of officers

2. Adoption of the agenda and organization of work

3. Interactions between the development of SMEs and of capital markets and banking systems:

   (a) Generation of domestic savings

   (b) Access to capital markets and other sources of financing

4. Identification of areas where technical cooperation in support of policy development to enhance the role of SMEs could be strengthened

5. Other business

6. Adoption of the report of the Ad Hoc Working Group to the Trade and Development Board

Annex II

SUMMARY PREPARED BY THE SECRETARIAT OF THE MAIN POINTS MADE IN THE DISCUSSIONS

Small and medium-sized enterprises in perspective

1. Small and medium-sized enterprises (SMEs) play a key role in the development process. In most countries, they account for more than 90 per cent of enterprises and over 50 per cent of total employment, sales and value added. They provide a breeding ground for entrepreneurs. Being labour-intensive, they are important job creators. By providing self-employment or employment as well as affordable essential goods to the poor, they help to fight poverty; by empowering women, they strengthen family structures. By encouraging personal savings and using retained savings, they help to mobilize domestic savings. They are able to use resources that may otherwise not be drawn into the development process. They contribute a significant, and in some countries a majority, share of total exports and foster export-led growth. Through inter-firm cooperation, they raise the level of skills; with their flexible and innovative nature, they can achieve flexible specialization. Their importance is bound to grow as globalization and liberalization lead to the outsourcing of production inputs and tasks by firms and as inter-firm networks spread through joint ventures, alliances, subcontracting and franchising arrangements. The national economy benefits through the trade, investment and technology flows which such inter-firm linkages bring. SMEs are particularly important for least developed countries embarking on the initial phase of their industrial development.

2. Thus the development of SMEs can generate important benefits in terms of creating a flexible and skilled industrial base, creating new industries, expanding trade, generating domestic and foreign investment and acquiring new technology. The development of a dynamic SME sector can help a country to adjust successfully to a globalizing and liberalizing world economy.

Regulatory framework and incentives structures

3. The State has a role to play in creating an environment conducive to enterprise development, including SMEs. This implies the creation of a favourable macroeconomic framework for business confidence, as well as a sound policy and commercial framework for business development. These "framework conditions" - macroeconomic stability and sound policy and commercial framework - are especially vital for SME development, given their relative weakness vis-à-vis the stronger players. In many countries, proactive policies supportive of SME development, together with appropriate institutional support, have been adopted. Macroeconomic stability facilitates structural change or industrial restructuring in order to create competitive enterprises, including SMEs. Thus, it is important that support programmes for SME development be properly designed and contribute to productive activities, so that they will be fiscally neutral and not undermine macroeconomic stability.

4. The commercial framework - including rules, laws and regulations governing the establishment and operations of companies, as well as legal

enforcement procedures - needs to be clear, stable, predictable and effective. As a general rule, it should apply to all companies irrespective of size. However, because of the limited resources of SMEs, certain administrative rules, for example, for the registration of companies, may be simplified and made less time-consuming at little or no cost for small businesses, including microenterprises, in order to facilitate their registration and to encourage business start-ups. Further, tax payment procedures may be simplified for small businesses by levying a small lump-sum tax without the need for the filing of tax returns or the keeping of detailed accounts, a measure used in India.

5. The regulatory framework may need to be reviewed periodically in order to make an *ex ante* analysis of the impact of business laws and regulations on entrepreneurial and business development and to determine ways of eliminating or reducing constraints on business activity. In this regard, reference may be made to the establishment in Norway of a Business Legislation Committee for such a purpose. In Mauritius, the Advisory Board established under the Small Scale Industries Act regularly reviews measures, including incentives, designed to promote SME development. In China, business regulations are reviewed and improved regularly, taking into account the interests of SMEs.

6. Fiscal and other incentives need to be reviewed in order to determine their usefulness. There is evidence to suggest, as for example in Brazil, that a level playing field with the right conditions for SME development matters more than fiscal incentives for SMEs. Furthermore, this review may extend to fiscal incentives to attract foreign investment, as there is evidence to suggest, for example from a survey conducted in the United Kingdom, that such incentives have little impact on locational decisions of foreign investors. The question has to be asked as to whether developing countries, by providing such incentives, are unnecessarily giving up tax revenue.

7. To the extent possible, regulations concerning, for example, environmental protection should support, rather than replace, market-based incentives, taking into account the problems faced by SMEs in meeting such regulations.

Institution building and institutional support

8. Where the State succeeds in creating an environment that enables markets to function properly and efficiently, so that SMEs are not disadvantaged because of their size in relation to large enterprises, the best policy towards SMEs may be one of "maximum openness, minimum intervention" (as little Government intervention as possible, as much of such intervention as necessary). There are instances, for example in Italy, where such an approach has created a considerable degree of independence and self-reliance among SMEs and has fostered rather than hindered their development. In any case, the State, if it cannot be helpful, should at least refrain from making operations difficult for SMEs by over-regulating or over-taxing them or by favouring large enterprises at the expense of small ones, which may in the process force the latter out of business.

9. However, where there are market distortions or failures, as for example where markets or inter-firm networks are controlled by dominant incumbents or where policies favouring large enterprises or the inefficient functioning of markets result in high cost, low quality or unavailability of essential inputs for SMEs, so that newcomers or SMEs cannot compete on an equal footing, the State may need to intervene to help SMEs by taking measures to correct or eliminate market deficiencies. One such measure is a loan guarantee programme which can play an important role in changing the attitudes and practices of commercial banks, thereby increasing the access to credit for SMEs. In the economies in transition, the restructuring of large enterprises into smaller, competitive and flexible firms has assumed particular importance. Such support should, however, be limited to creating a "level playing field", with the ultimate objective of creating competitive enterprises in domestic and foreign markets. Furthermore, the objective of fighting poverty or creating jobs should be kept separate from that of creating viable and efficient enterprises. Other means should be used rather than subsidizing enterprises for creating jobs or combatting poverty. Moreover, there is evidence, as for example in Japan, United Kingdom and United States of America, to suggest that removing business restrictions, including barriers to market entry, and promoting competition can enhance job creation.

10. Market failures do not include only deficiencies in financial or other markets. Lack of communications infrastructure, including roads and telecommunications, causes other forms of market failure. Telecommunications are, in fact, the lifeline of business activity; markets cannot function without effective flows of information. It is hardly possible to conceive of networking, so essential for the development and modernization of SMEs, without adequate telecommunications. Likewise, the absence of adequate roads means that subcontracting cannot be extended to SMEs in rural areas, thus depriving them of the related benefits.

11. Market failures may assume a different character in the countries which are still moving towards a market economy and where the foundations of such an economy have yet to be put in place. In addition to various market failures, including "information failure", the commercial framework may be characterized not only by a lack of basic laws but also by a lack of consistency and stability in the existing laws.

12. It is nevertheless recognized that there may be instances where SMEs may need to be provided with particular assistance by the State. This need may arise where the cost of compliance, for example with environmental standards, or the increased cost of capital due to bad macroeconomic management is disproportionately higher for SMEs than for large enterprises. Furthermore, in Japan, subsidized loans by financial institutions created to cater to the needs of SMEs are provided in special cases, such as for the modernization of production facilities, the relocation of plant or the conversion of business activities following structural change.

13. Various Governments, as for example Canada, France, Indonesia and the United Kingdom, have established Ministries or Departments for Small Business to act as a catalyst or a "lightning rod" for Cabinet-level policy development in support of SMEs.

14. Policy development concerning SMEs needs to involve a process of consultation with the private sector and SMEs, including through their organizations. While the design of effective support programmes for SMEs will vary, depending on the specificity of country situations and policies, some general principles may be identified for this purpose.

15. First, the organization of support services needs to be market-based; in other words, support services should complement, rather than duplicate, private-sector initiatives or services, in such areas as training, market information, business advice, export marketing or technological upgrading. The provision of support services can be costly; there is thus a need to ensure that such services are cost-effective and that the charges for them reflect their real market value. As regards business advisory services for SMEs starting up business for the first time, it may be argued that such services should be provided at a moderate cost and that any subsidization may be offset by subsequent increased tax revenue.

16. Secondly, attention needs to be given to improving the policy and commercial framework for SME development by identifying market deficiencies and regulatory constraints to business development and suggesting the modalities for improvement.

17. Thirdly, support services should help to enhance the availability and effective utilization of essential inputs commonly needed by SMEs, including finance, physical facilities and equipment. Measures to overcome deficiencies in markets for supply of inputs can play an important role in enhancing their availability to SMEs. Cooperation at the local or regional level, for example, in sharing R&D costs and developing basic support services, can also yield important benefits.

18. Fourthly, attention needs to be given to encouraging or fostering inter-firm cooperation so as to increase the skills, technological capacity, production and trading opportunities of SMEs through inter-firm networks. In some countries, the Government has set up a subcontracting exchange for this purpose, as for example in Malaysia. Inter-firm cooperation, including subcontracting, between foreign and domestic firms, and among domestic firms, together with its trade, investment and technology linkages, allows SMEs to modernize themselves; it also exposes them to the rigours of international competition and to the workings and demands of the international marketplace. Various countries, including Thailand and Singapore, have adopted policies to encourage foreign investors to establish linkages with domestic firms through subcontracting arrangements. However, care should be taken to avoid over-dependence on subcontracts. Such over-dependence, together with information failure, has led to serious difficulties for a number of SMEs which suddenly lost their subcontracts when demand for the products of the contracting firms fell, as in Mauritius. Industrial districts may also be encouraged and supported in order to create the benefits of flexible specialization.

19. The administration of such support services may be entrusted to a lead agency. In such agencies both the public and private sectors should participate on the executive boards. In Mauritius, the agency is chaired by a representative of the private sector. In some countries, many of the support

services are provided by private institutions, such as for instance SEBRAE in Brazil. Coordination of the lead agency's activities with those of specialized institutions, such as in the areas of automation applications, science and technology, information technology, productivity improvement and standards and industrial research, would help to ensure a coordinated or integrated approach to assistance. For example, financial assistance for the purchase of equipment would need to be integrated with technical support for the operation of the equipment, where needed, if assistance is to be effective. In the United Kingdom for example, the Business Links programme integrates a wide variety of services, ranging from business consultancy to export services, in one-stop shops. The development of appropriate software packages for use by SMEs, for example in the area of accounting, can help to reduce the cost of, and thus promote, the application of information technology by SMEs, thereby helping them to improve their operations and to reduce costs. Inter-firm linkages may be established through the Internet World Wide Web or the Global Trade Point Network.

Human resources development

20. Investment in basic education has contributed significantly to the development of competitive, export-oriented SMEs, as in the East Asian economies. In Norway, entrepreneurial education is being introduced from the primary to the university level in order to make the educational system, in cooperation with the private sector, a producer of job creators. However, in many countries, the educational system tends to produce job seekers rather than job creators. Moreover, a low social value is attached to entrepreneurship in many countries. In some countries, this problem is compounded by the identification of private enterprises with foreign ownership. A change in perception and attitudes is thus necessary if entrepreneurship is to be socially valued and encouraged.

21. In addition to basic education, there is a need to develop skills needed by the business world through training and retraining programmes, including vocational and apprenticeship training. Germany has developed an apprenticeship system combining theoretical education at specialized institutions with on-the-job training on the shop floor. Such training programmes may be provided by Government or the private sector with financial support of the Government, if necessary, through in-firm or inter-firm arrangements. In Canada, a Government-financed comprehensive training programme, managed by an NGO, now forms part of the curriculum of most universities and colleges. EMPRETEC, a United Nations programme managed by UNCTAD in cooperation with the Department of Development Support and Management Services, has helped developing countries to identify and develop entrepreneurial talents.

Microenterprises and the informal sector

22. Microenterprises play an important economic and social role in terms of fostering entrepreneurship, creating self-employment and other employment opportunities especially for the poor, as well as providing services and affordable essential goods to the poor. Microenterprises are often themselves the products of poverty and of conditions of unemployment. However, not all

microenterprises are associated with poverty. Nevertheless they are often associated generally with the informal sector in the sense of operating outside the formal system of regulations and taxes, although not all of them do so.

23. A major issue regarding microenterprises is why they are found in the informal sector and the extent to which this situation can be attributed to "regulatory failure". Understanding the reasons can help to shape policies that can assist microenterprises in the informal sector to grow or to graduate to the formal sector without destroying their important economic and social role or, worse still, forcing them into illegal activities, while recognizing that not all such enterprises wish to grow or to join the formal sector. Various kinds of measures may be taken for this purpose, including providing finance and physical facilities, as well as simplifying registration procedures and reducing the cost of administrative compliance. The creation of physical facilities for microenterprises in the informal sector can help to formalize their operations as well as provide them with stability and the type of environment which allows them access to credit and to acquire assets. In Ecuador, for example, microenterprises have obtained access to finance and other benefits through registration. While there is a tax obligation with registration, those unable to pay taxes are given exemptions and are able to operate formally without worrying about taxes. In China, the authorities tend to leave microenterprises alone. In the final analysis programmes to promote basic education and to raise skill levels may be the most effective way of helping microenterprises integrate into the formal sector. Investment in such programmes can bring long-term benefits in terms of strengthening entrepreneurship, increasing competition and enlarging tax receipts.

The role of SMEs in export development

24. There is evidence, for example in the high-performing East Asian economies, to suggest that rapid and successful economic development can be achieved through policies promoting export-oriented SMEs. The evidence suggests that the road to development is through expanding exports, since such earnings, inter alia, facilitate structural change and support higher growth rates by enhancing import capacity, with the implication that the focus of government policy and the often limited resources available may need to be targeted at viable SMEs with the potential to modernize and grow into successful exporters. Two types of approaches may be distinguished, one used in the Republic of Korea, which has identified potential SME exporters in terms of the targeted export industries and put them through a modernization programme, the other, used by Japan, where trading companies have played an important role in fostering the development of SME exporters. The East Asian economic experience may be relevant for Africa; it is neither a miracle nor a trade secret.

25. A number of factors are involved in the development of SME exporters. In addition to an environment conducive to private sector development - including its macroeconomic, policy, legal and regulatory aspects - appropriate policy initiatives and measures may be needed in order to facilitate or support the export efforts of SMEs.

Support measures for export development

26. The availability of support in the way of credit facilities, training, information, advice or technical support can make a critical difference in overcoming constraints or in creating confidence, particularly for enterprises new to the business of exporting or of branching out abroad. SMEs have to act and think internationally and need to have the right skills, including management and marketing skills, information about potential markets (for example packaging and quality standards, market potential and competition, trade measures and procedures, etc.) and channels for penetrating foreign markets, particularly in the first phase. Inter-firm networks can be an important source of help in some of the above areas. In fact, exporting is very often a question of building up contacts and creating inter-firm networks.

27. Export development activities need to adhere to the same principles as described above (see paragraphs 8 and 9) to ensure that they are trade-creating and not trade-distorting. Transparency and international consensus on the appropriate role of the State can help to minimize risk of firms becoming unnecessarily exposed to trade conflicts. When developed on sound economic principles, export development activities can help to foster a climate of public support for open trade policies.

28. Exporting is a matter of quality and price. It involves exporting a country's reputation. If the reputation is damaged, then exporters will find it more difficult to export or may suffer from reduced prices and not be able to obtain full market value for their products. While big firms may not suffer as much from such a situation, in the sense that they can build up a reputation for their own brand names, SMEs are likely to suffer even if their own products meet the right quality standards. Services provided in this area, for example by a common facility centre for quality control and productivity improvement, can thus be of great importance. Furthermore, meeting quality standards also means that such products can face import competition. In fact, in a globalizing and liberalizing world economy, the issue is not whether to pursue a policy of import substitution or of export promotion but to produce goods that meet world standards which can be supplied as much to the domestic market as to foreign markets.

29. In addition to quality, SME exporters need to be exposed to the preferences and requirements of foreign markets so as to be able to produce goods that meet those needs. In addition to trade fairs and foreign trading companies, networking of domestic firms with foreign partners well acquainted with their own markets, undertaking subcontracting jobs for foreign firms, and the gathering of market intelligence by overseas trade missions or by company networks can all provide useful information. Foreign tourists are another source of information concerning foreign preferences in terms of design and quality. By being able to adapt to changing preferences and order sizes by working on short production runs, SMEs in Bali, Indonesia, have been able to create a flourishing garment industry and a niche market for their products. There is also a potential niche market for African products, including so-called Afrocentric products and standardized garments, in the United States.

30. Other services provided for SME exporters in various countries comprise credit facilities, including credit guarantees, training programmes, provision of management expertise, export information and advisory services and the organization of trade fairs. Examples include: in Japan, an Export Financing Loan Guarantee scheme for SMEs to ensure that they have access to export financing services and export insurance; in Canada, the First Time Exporter's Programme designed to help first-time exporters to set up an export business, a Cross-border Export Training Programme and a database service listing companies and products; in Norway, the Export Manager for Hire Programme under which a consultant is provided to a company to help it set up its export business, the Commercial Network Programme, designed to create alliances or networks among SMEs in areas such as export activities, purchasing and R&D, and a programme designed to provide loans partially to meet the cost of establishing SME sales subsidiaries abroad; and in the United Kingdom, the Business Link Network designed to establish a national network of one-stop centres to provide an integrated package of services to SMEs, including exporters. Various other countries, including China, Japan, France, Germany and Mauritius, have also established export information and advisory services to SMEs. The organization of trade fairs, often in cooperation with private sector organizations, provides a highly valued service to SME exporters, allowing them to come into contact with potential customers and business partners.

31. Fees charged for the services provided can be proportionate to the total cost or be on a sliding scale over a certain period. In some cases, the successful exporters are required to reimburse the Government's share (where the full fee is not charged initially) from their export revenues, as is the case of the First Time Exporter's Programme in Canada. In the United Kingdom, the Government subsidizes the participation of SMEs in trade fairs up to three times in a given market, after which they have to pay the full cost involved. Particular attention needs to be given to evaluating the services provided and establishing suitable fees; quite often, services provided tend to be under-valued by the users until they are delivered.

32. Steps may be taken to create a regional plan or framework for the development of SMEs in order to facilitate inter-firm cooperation in production, trade and other areas, including through the establishment and networking of SME associations. Such cooperation can help to remove some of the anomalies in trade flows in Africa, whereby, for example, bicycles manufactured in Nigeria are shipped to the United Kingdom before being exported to Ghana, or prawns are shipped from the United Republic of Tanzania to Switzerland before being exported to Zimbabwe (the latter due to foreign exchange considerations). It is noted that plans for regional cooperation among SMEs are being formulated for APEC and ASEAN. Moreover, SEBRAE of Brazil is building up links in the MERCOSUR region, which allow the support agency to provide its various services to SME exporters and importers, as well as to bring them together, within the region. In order to expand trade in the context of regional or inter-regional cooperation, counter-trade networks may be established.

Suggestions for further studies

33. Various suggestions for further studies have been made, including a study on the nature and causes of market failures inhibiting the viable development of SMEs in selected countries, including least developed countries, and the modalities needed to address them, with reference, inter alia, to the role of cooperatives, as well as the nature and manner of government intervention. Such a study may also address the reasons why markets serving the African indigenous agricultural sector have failed to develop into a normal healthy market system. Another area for study is the informal sector, particularly the extent to which market failure or "regulatory failure" may have affected its development or growth, as has been found in Brazil for example.

Annex III

MEMBERSHIP AND ATTENDANCE*

1. The following States members of UNCTAD, members of the Ad hoc Working Group, were represented at the session:

Algeria
Argentina
Bangladesh
Bolivia
Brazil
Cameroon
Chile
China
Côte d'Ivoire
Czech Republic
Egypt
Ethiopia
France
Gambia
Germany
Greece
Honduras
India
Indonesia
Jamaica
Japan
Madagascar
Malaysia
Mauritius
Mexico
Morocco
Netherlands
Nigeria
Norway
Philippines
Poland
Republic of Korea
Romania
Russian Federation
Slovakia
Switzerland
Thailand
Tunisia
Turkey
United Kingdom of Great Britain and Northern Ireland
United Republic of Tanzania
United States of America
Venezuela
Zambia
Zimbabwe

2. The following other States members of UNCTAD, not members of the Ad hoc Working Group, were represented as observers at the session:

Bulgaria
Costa Rica
Ecuador
Iraq
Myanmar
Nepal
Portugal
Qatar
South Africa
Sri Lanka
Trinidad and Tobago

3. The Economic Commission for Africa was represented at the session.

International Trade Centre UNCTAD/GATT was also represented at the session.

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* For the list of participants, see TD/B/WG.7/INF.1

4. The following specialized and related agencies were represented at the session:

International Labour Organization
United Nations Industrial Development Organization

The World Trade Organization was also represented at the session.

5. The following intergovernmental organizations were represented at the session:

European Community
Islamic Development Bank
League of Arab States
Organization of African Unity

6. The following non-governmental organizations were represented at the session:

General Category

World Association of Small and Medium Enterprises
World Federation of United Nations Associations

PANELLISTS

Mr. CHEE Peng Lim, Director, Bureau of Economic Cooperation, ASEAN Secretariat, Indonesia
Mr. William FINSETH, Economic Development Specialist, Southern Africa Division, Canadian International Development Agency, Canada
Mr. Halward HERVIEU, Chef, Bureau de la modernisation des enterprises, Direction de l'artisanat, Ministère des enterprises et du développement économique, Chargé des petites et moyennes enterprises et du commerce et de l'artisanat, France
Mr. Hussein KIARATU, Head, SME Advisory Group, Confederation of Tanzanian Industries, United Republic of Tanzania
Mr. Zoltan ROMAN, President, Hungarian Small Business Association, Hungary
Mr. José Carlos VIEIRA DE FIGUEIREDO, Director, Superintendent, SABRAE/Rio de Janeiro, Brazil

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